After the Storm

"Cautiously Optimistic" is the best way to describe the mood of those closely monitoring the national economy in July. Recovery seemed to have a substantial foothold in the U.S. economy, but analysts were warning of some possible bumps in the road ahead. Then a real bump hit us. A big bump named Katrina. What lies ahead for the U.S. economy?

Job growth was the driving force behind the summertime optimism: 207,000 new jobs were created in the month of July and another 169,000 in August. These gains may have signaled a change from a "jobless" to a "job-filled" recovery, but the impact of Hurricane Katrina could very well cancel any of the prior economic gains. Whether or not that is the case is an unanswerable question at this time. Currently, the best estimates indicate that over 200,000 individuals lost their jobs due to Katrina.

With the exception of manufacturing, all industries shared in the July employment growth, which was mainly driven by the creation of 50,000 retail jobs. Approximately 10,000 of these retail jobs were posted by automobile dealerships alone, whose increase is most likely driven by rising sales resulting from the deep discounts offered by many auto makers during the summer months. In August, job growth was primarily driven by construction, healthcare, accommodations and food services.

The national unemployment rate held steady from June to July at 5.0 percent, which, coupled with the job growth figures, implies that workers are entering or reentering the job market as a result of a more positive job outlook. In August, the unemployment rate dropped only slightly to 4.9 percent. The effects of Hurricane Katrina are not reflected in the August unemployment rate because the devastation occurred after the data was collected. September's unemployment rate should reflect the immediate impact of the hurricane on employment and it will be interesting to see if the labor market is able to absorb these displaced workers in a timely and efficient fashion. During the week of September 11th, 432,000 unemployment insurance claims were processed.

While workers increased their year-over weekly earnings by a seasonally adjusted 2.7 percent in July 2005, that increase was eaten away by inflation (3.2% year-over change in CPI-U) which was primarily driven by higher gas prices. The effects of higher gas prices will continue to eat away at purchasing power.

Will rising inflation continue? In the short run, yes. Current price increases are a sign that businesses are no longer able to absorb the effects of rising oil prices. Current inflation appears to be the result of producers passing the increasing cost of oil on to their consumers. And once that door has been opened, businesses will likely continue to pass on this cost, at least until consumers respond by slowing their spending.

Inflation, driven and compounded by rising energy and construction material prices, could further impact the economy by slowing the housing market. The average price for a newly constructed home is expected to rise with energy prices, making consumers more reluctant to purchase homes as they are forced to cut back spending to compensate for rising prices. In addition, the Federal Reserve raised interest rates by a quarter-point in August, indicating a desire to keep inflation in check. With probable interest rate hikes in our future, we should eventually see prices catch up to the housing boom and deflate it.

Suffice it to say that while the summer of 2005 seemed initially to be a good one for the US economy, Mother Nature has since dealt it a blow from which it may take years to recover. Does that imply a recession is looming? Probably not, but even that can change.